

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2002-526

July 3, 2003

NORTHERN UTILITIES, INC.,
Request for Approval of Affiliated
Interest Transaction for Amendment
To a Gas Transportation Contract with
Granite State Gas Transmission, Inc.

ORDER

Welch, Chairman; Nugent and Diamond, Commissioners

I. SUMMARY

We deny Northern Utilities, Inc.'s (Northern or NU) request for approval of its proposed "Fourth Amendment" to its contract with its affiliate, Granite State Gas Transmission, Inc. (Granite) because we find its terms are adverse to the public interest. We would approve a 1-year contract amendment, through October 31, 2003, with the proposed volume of 84,000 Dth/day at Granite's current FERC rate.

II. PROCEDURAL HISTORY AND BACKGROUND

On August 30, 2002, Northern filed a request for approval of an agreement with its affiliate, Granite, to allow it to increase its commitment for pipeline capacity on Granite's system from 84,000 dekatherms per day (Dth/day) to 112,000 Dth/day for a term of five years. Northern referred to this agreement as the "Third Amendment" to an underlying Gas Transport Contract, FT-NN Contract Number 93-201-F (Contract) with Granite dated November 1, 1993, which was approved by the Commission. The Gas Transport Contract was for a maximum daily quantity of 28,768 dekatherms at Granite's tariffed firm transportation rate until November 1, 2000 but continuing month to month thereafter "unless cancelled by either Party upon one year's written notice."

The Contract was amended twice, increasing Northern's quantity of pipeline capacity first to 66,000 Dth/day effective November 1, 2000 and then to 84,000 Dth/day effective November 1, 2001. The Commission approved these First and Second Amendments in Docket Nos. 2000-619 and 2001-634. The Second Amendment also stated that it would "remain in effect for a period of one year to be coterminous with the Contract" and that "All other provisions of the Contract shall remain in full force and effect."

In its Third Amendment filing, Northern maintained that the increase of capacity from 84,000 to 112,000 Dth/day would be necessary to provide transportation for gas supply commitments it had entered into when it decided not to construct a liquefied natural gas (LNG) facility in Wells, Maine. Northern requested approval of the Third Amendment by November 1, 2002.

On September 26, 2002, the Hearing Examiner issued a Procedural Order containing a schedule and an additional data request. On October 2, 2002, Northern requested a suspension of the procedural schedule to allow it to investigate potential changes to its proposed Third Amendment, which provided for provision of 112,000 Dth/day for five years at a discounted rate. Following discussions among the parties in which Staff indicated that it could not recommend approval of the proposed contract quantity, on October 10, 2002, Northern filed a letter indicating it was in the process of renegotiating the terms of a transportation agreement with Granite to supply 89,300 Dth/day for one year at Granite's maximum rate filed with the FERC "as an interim solution to its long-term resource needs."

On October 11, 2002, via electronic mail, Northern requested that the Staffs' of both the Maine and New Hampshire PUCs, and the public advocates from both states, participate in a telephone conference to discuss "recent developments in the negotiations with Granite." Northern indicated that, in its view, it was important to have both states involved in the discussion to achieve a common understanding and, if possible, a consensus between the two jurisdictions on the current issues because separately regulated divisions of Northern operating in each state would receive service under this contract.

Two teleconferences were held on October 17, 2002 during which Northern explained that Granite was unwilling to amend the transportation agreement with Northern to the extent desired by Northern because of what Granite considered to be restrictions resulting from its status as a federally regulated pipeline. Granite asserts that the Third Amendment was already a binding contract on Northern even without Commission approval pursuant to 35-A M.R.S.A. §707. During the conference, the parties discussed the legal and regulatory implications of Granite's position and gave initial reactions to Northern's circumstances.

The Hearing Examiner required Northern to file Supplemental Testimony in this proceeding to make its additional arguments part of the record. In addition, the Hearing Examiner required Northern to file a legal opinion regarding the status of its Second and Third Amendments for transportation capacity with Granite by October 23, 2002. The OPA filed a responsive legal opinion on October 28, 2002. Due to the need for additional time to await and consider Northern's revised contract proposal, the Commission suspended the statutory deadline of October 29, 2002 on this case for an additional 60-days.

On October 30, 2002, Northern filed the Supplemental Testimony of Francisco DaFonte and requested that the Commission resume consideration of its initial 5-year contract proposal with Granite. The Staff issued data requests on the supplemental testimony on November 4, 2002.

A further telephone conference was held on November 14, 2002 for possible discovery and to discuss the next steps in this proceeding.

As has been customary in circumstances where the Company is the source of delay in cases with a statutory deadline, Staff requested that the Company withdraw and refile if additional time were necessary to complete the regulatory review. The Company agreed to do so and on December 19, 2002 withdrew its pending petition for approval of the Third Amendment.

On March 4, 2003, Northern submitted a new amendment to its contract with Granite, identified as the "Fourth Amendment," for approval pursuant to 35-A M.R.S.A. § 707. The Fourth Amendment maintains the same price and quantity of capacity as that contained in the Second Amendment, 84,000 Dth/day, at Granite's FERC approved rate, but "extends the term of the Contract an additional seven (7) years." Northern March 4, 2003 Petition at 2. Northern states that it anticipates that its load will continue to grow over the contract term and will "monitor its need for additional incremental capacity during the contract period." The preamble section of the Fourth Amendment states that it will "supercede and replace the Third Amendment to the Contract," although the Third Amendment was never approved by this Commission.

On June 6, 2003, Northern filed responses to Staff's final data request. The statutory deadline for review and final action on the Fourth Amendment is July 3, 2003.

III. ANALYSIS OF PROPOSED FOURTH AMENDMENT

Granite is an interstate pipeline regulated by the Federal Energy Regulatory Commission (FERC) that extends from Dracut, Massachusetts to Portland, Maine. Granite connects Northern to the PNGTS/MNE Joint Facilities in Westbrook. Granite is an affiliate of Northern pursuant to 35-A M.R.S.A. §707. This provision requires that, before such agreements may take legal effect, the utility must obtain the Commission's written approval, determining that the agreements are not adverse to the public interest.

This case presents two issues: Is the proposed Fourth Amendment to the contract in the public interest? And, if the proposed Fourth Amendment is not in the public interest, how should the Commission direct Northern, the parties to this case, and the Staff to proceed?

Like most contracts, the Fourth Amendment has three primary components, namely, the amount of Granite capacity which Northern will purchase from Granite, the price for that capacity, and the term of years for which the contract will remain in effect.

At the time of its Third Amendment filing, Northern was purchasing 84,000 Dth/day pipeline capacity from Granite at maximum FERC rates (currently \$1.66 per therm) pursuant to the Second Amendment.¹ The Fourth Amendment is also for 84,000 Dth per day, which Northern apparently chose (after withdrawing its Third Amendment proposal of 112,000 Dth/day) because it was consistent with the PUC Staff's position that this amount would be adequate to serve Northern customers during the 2002-03 heating season. With the benefit of hindsight, it appears that 84,000 Dth per day was more than adequate last year.²

On the other hand, Northern may need more than this amount in the future. The proposal to contract for a constant 84,000 notwithstanding, Northern believes that it will require additional firm capacity in the future for which it expects to propose future amendments for additional capacity³. Response to Advisors' Data Request No. 4-1. In fact, Northern's forecast suggests that 84,000 Dth will be adequate for the 2003-04 season (assuming full utilization of its on-system storage) but that additional capacity would be needed thereafter.⁴ The contract does not contain any provisions suggesting how these additional quantities will be provided.⁵

The price proposed in the Fourth Amendment is the same as the one contained in the Second Amendment, the maximum rate under the current FERC approved tariff. On one hand, this is reasonable given the presumption that FERC set rates are reasonable. *Narragansett Elec. Co. v. Burke*, 381 A.2d 1358 (R.I. 1977, cert. denied, 435 U.S. 972 (1978)). On the other hand, one would expect that a prospective purchaser would consider what options might be available in bargaining for a lower price. Given Northern's physical dependence on Granite, its best leverage would appear to be to file, or indicate a willingness to file, a case at the FERC arguing that the current Granite rate is unreasonably high. Such cases are fairly common; both of the other interstate pipelines operating in Maine have had their FERC approved rates

¹ The withdrawn Third Amendment proposed to increase capacity to 112,000 Dth/day at a discounted rate of \$1.51 per therm.

² Northern's actual peak use of Granite for the 2002-2003 winter season was 72,225 Dth. On the peak day, Northern also had approximately 15,000 Dth of unused on-system supplies, such as LNG and Propane-Air Injection, which presumably could have been used to further reduce use of Granite. If Northern had fully utilized its on system storage at the time of peak, it would have needed roughly 55,000 Dth of Granite capacity in order to maintain reliability at the time of actual peak. While some level of reserve over actual peak needs is desirable, last year's 50% margin, in hindsight, does not appear to suggest that there would be a reliability problem at a somewhat lower level of capacity than it has proposed.

³ Exhibit FCD-1 of its filing shows Northern's forecasted sendout volumes from 2002-2003 to 2006-2007 as exceeding its total capacity resources by 10,404 to 22,289 Dth/day. Northern includes a 10% Contingency Capacity component, or about 12,500 Dth, in this forecast as insurance to cover its transportation customers' needs in case of supplier default.

⁴ Exhibit FCD-1.

⁵ It seems safe to expect that these additional volumes are likely to be available given the limited role of Granite's system in the region.

reduced recently. On the other hand, a utility may face conflicting incentives in deciding whether to bring a rate case against an affiliate.

The purpose of affiliate interest transaction laws is to replicate, to the extent possible, arms' length dealings. The utility must demonstrate that its proposed agreement with an affiliate is not dominated by the affiliation to the detriment of the public interest. When negotiating an agreement with an affiliate, we expect a utility to act as if its own money were involved. Here we see ample reason for Northern to doubt whether it would be overpaying for Granite's service. To us, the Fourth Amendment does not have the appearance of an arms' length transaction. Rather, it suggests the influence of one affiliate over another.

For instance, Northern has stated that it has not analyzed whether the prices and quantities under the proposed contract would result in a windfall to Granite under the currently approved FERC rates. Response to ADR 4-4. However, Granite, Northern's affiliate and counterpart, has indicated in response to a request from the NH PUC staff that its current revenue requirement is substantially lower than the revenue requirement in its most recent FERC rate case.⁶ The Staff, in coordination with the NH staff, has retained a consultant to further review the reasonableness of Granite's rates and has initiated discussions with Granite and Northern on this point.

The contract also has a seven-year term. Northern indicates that the reason for this is that Granite insisted upon this term in order that the contract would produce an amount of revenue at least equal to the revenue under the previously proposed, but now withdrawn, "Third Amendment" between Granite and Northern.⁷ We do not consider this a compelling reason. We see no benefit to approving an extended term that does not appear to provide Northern with any clear advantage over a more flexible year-to-year arrangement.

At Granite's current maximum firm transportation rate and with increased volumes, the Fourth Amendment establishes a price component that is likely too high and will become even more so over time. It is not in the public interest to approve a multi-year contract whose quantities may soon be inadequate and whose price is likely too high. We expect that, like most pipelines, a substantial portion of Granite's cost of service is independent of the volume of capacity under contract. This suggests that as Northern's need for additional volumes from Granite rises, the rate for purchases should

⁶ In New Hampshire Docket DG 00-172, Staff Request 1, Response 2, Granite indicates that the cost of service (COS) from its last FERC case was \$4.1 million while its updated COS for the years ending 12/31/01 and 9/30/02 were \$2.9 million and \$2.5 million, respectively. Granite also notes that the updated figures do not reflect any ratemaking adjustments for a merger related acquisition adjustment.

⁷ It is not clear to us what legal basis, if any, Granite has for this insistence. On June 6, 2003, Northern reported that it is currently taking service from Granite pursuant to Granite's FERC approved tariff and that no contract has been filed with, or approved by, the FERC. Furthermore, the Third Amendment was never approved by this Commission and is, therefore, void pursuant to 35-A M.R.S.A. § 707 (3).

decline, even if the cost of service remains constant. Furthermore, if Granite's cost of service has declined, as they have indicated, then the existing rate is doubly likely to be too high. Accordingly, we direct both Northern and our own Staff to review Granite's costs and, if necessary, to begin actions to have rates more closely aligned with costs and volumes.⁸

In the meantime, while we would deny Northern's petition to approve the Fourth Amendment for the reasons outlined above, we do find that terms of 84,000 Dth/day at Granite's current FERC firm transportation rate for the one year period of November 1, 2002 through October 31, 2003 are reasonable for this period of time and we would approve an amendment to the Contract that contains these parameters.

IV. CONCLUSION

We do not believe that it is in the public interest, or the ratepayers' interest, to approve the Fourth Amendment to the Contract as discussed above. Rather, we suggest that Northern, the parties to this case, and the Staff consider whether it is possible to structure a multi-year contract that meets two primary criteria. First, the contract should provide reasonable assurance that necessary Granite capacity will be available to Northern customers on reasonable terms. Second, the contract should balance Granite's interest in having a reasonable likelihood of recovering its cost of service with Northern's parallel interest in having a reasonable likelihood of not paying more than the cost of service. Finally, we would approve an amendment with a term ending October 31, 2003 at 84,000 Dth and the current FERC rate.⁹

Dated at Augusta, Maine, this 3RD day of July, 2003.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Diamond

COMMISSIONERS ABSENT: Nugent

⁸ We recognize that FERC has jurisdiction over such rates and that any changes would be subject to its procedures.

⁹ Any such contract should not indicate that it supercedes and replaces the Third Amendment as no such amendment has been approved by this Commission.

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.
2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within **21 days** of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.
3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.